CHAPTER 3

KEY ISSUES

3.1 The majority of submissions and witnesses expressed strong in-principle support for the Bill and its objectives. However, submissions and witnesses drew to the committee's attention a number of technical matters raised by the Bill which, they argued, require further consideration prior to implementation. This chapter examines the main issues and concerns raised in the course of the committee's inquiry.

In-principle support

3.2 Submissions and witnesses welcomed the Bill as a means of removing the potential loophole highlighted by the decision of *Cook v Benson* by enabling the recovery of superannuation contributions made prior to bankruptcy with the intention of defeating creditors. The general view was that the Bill represents a workable and balanced approach between the interests of bankrupts and the interests of creditors, at the same time minimising any active role for superannuation fund trustees.[1]

3.3 Some submissions and witnesses also commented that the Bill represents a simpler, less costly and preferable approach to earlier Federal Government proposals for reform in this area.[2]

Consultation

3.4 Many of those who provided evidence to the committee commended the extensive nature of the Federal Government's consultation process in relation to the Bill.

3.5 For example, the Australian Finance Conference noted that it has had 'a good opportunity to participate in discussion on the policy in this Bill along with a range of other policy proposals related to personal insolvency over recent years'.[3]

3.6 Dr Brad Pragnell from the Association of Superannuation Funds of Australia (ASFA) told the committee that:

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1 For example, see The Institute of Chartered Accountants, *Submission 1*, p. 1; ANZ Banking Group, *Submission 3*, p. 1; Mr Paul Cook, Insolvency Practitioners Association of Australia, *Committee Hansard*, 23 January 2007, pp 7 & 8; Dr Brad Pragnell, Association of Superannuation Funds of Australia, *Committee Hansard*, 23 January 2007, p. 2.

2 For example, see Dr Brad Pragnell, Association of Superannuation Funds of Australia, *Committee Hansard*, 23 January 2007, p. 2; Mr Paul Cook, Insolvency Practitioners Association of Australia, *Committee Hansard*, 23 January 2007, p. 7; Mr Michael Lhuede, Law Council of Australia, *Committee Hansard*, 23 January 2007, p. 11.

3 *Submission 9*, p. 1.

> We were quite involved in discussions with [the Department of the] Treasury and [the] I[nsolvency] T[rust] S[ervice] A[ustralia] in earlier consultations back in 2003, 2005 and more recently around this bill. I think generally we have found the process has been quite good. Those agencies have been very open to listening to industry concerns. In respect of cost and complexity we were quite pleased, as I mentioned in our opening remarks, to see that there was a rethink around the 2005 proposals, which would have imposed considerable cost and complexity. Other than maybe finessing certain aspects of this bill, we think that the regime is definitely a significant improvement and definitely achieves the policy objectives that were set out back in 2003.[4]

3.7 The committee acknowledges the comprehensive and wide-ranging consultation undertaken by the Federal Government in relation to the Bill.

Technical issues

3.8 Some submissions and witnesses submitted that, despite the overall soundness of the approach taken in the Bill, certain provisions may warrant minor technical amendment to improve their practical operation or to avoid unintended consequences. Some of these issues are discussed below.

Delay in commencement

3.9 The committee received some evidence suggesting that the commencement date of the substantive provisions of the Bill should be delayed until 1 January 2008 to allow implementation of the necessary changes to administration systems, processes and procedures.

3.10 As Dr Pragnell from ASFA told the committee:

> ASFA does have concerns about the capacity of the [superannuation] industry to implement the necessary changes to administration systems, processes and procedures to deal with processing payments and freezing notices within a relatively short time frame. Superannuation funds have limited resources. Simplified superannuation proposals and the anti-money laundering counterterrorism financing changes both come into force during 2007 and represent significant administrative challenges to be faced by funds and administrators. ASFA therefore requests, in consideration of these other changes, that the substantive proposals contained in this bill commence on 1 January 2008. We do recognise, however, that the regime must apply to contributions that were made on or after 28 July 2006.[5]

3.11 AXA Superannuation and the Investment & Financial Services Association (ISFA) also argued that commencement of the Bill should be no earlier than 1 January

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4 *Committee Hansard*, 23 January 2007, p. 3.

5 *Committee Hansard*, 23 January 2007, p. 3.

2008 to give the superannuation industry the necessary time to implement the required changes.[6]

3.12 When questioned at the hearing about the cost to industry and the scale of setting up any relevant systems and procedures, representatives from ASFA were unable to provide the committee with detailed information to support their arguments for a delayed commencement date. However, the representatives articulated some general concerns:

> Our members really would appreciate some additional time from when this bill becomes an act to be able to work through what is required. Even at this point I think they are going to need to work through what these notices are going to look like, how they are going to receive the notices, how they are going to be dealt with, what processes they are going to put in place to deal with them, how the moneys are going to be paid out and how they are going to record that data. So coming out of this are a number of systems issues that will require some level of at least one-off activity from the trustees. I think that is what this kind of regime actually does. Once you set it up, it kind of rumbles along in the background, like everything else. But the start-up of it does require a reasonable burst of resources. I wish I could provide you with some more detailed costings or scale …[7]

3.13 Conversely, Mr Paul Cook from the Insolvency Practitioners Association of Australia (IPAA) informed the committee that his organisation is 'happy to begin as soon as possible'. Mr Cook elaborated:

> Our view is that, since the Cook v Benson statement came down on 16 September 2003, it is fair to say that the industry has been on notice for quite some time that there are changes in this area. Trustees at the moment write to the superannuation funds about information because, if you do something to fool creditors, those funds are available. This change is about affecting something where an anomaly popped up. That is not to say that trustees do not already write to trustees who receive the funds at the moment.[8]

3.14 In response to the superannuation fund industry's concern that there may not be adequate time for implementation, representatives from the Insolvency and Trustee Service Australia (ITSA) noted that the onus is on the bankruptcy trustee, through the Official Receiver Notice, to provide the evidence in support of the claim for payment. That is, the only positive obligation on the superannuation fund is to pay the relevant monies. Notwithstanding this, the representatives acknowledged that there will be some implementation issues for superannuation funds:

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6 *Submission 8*, p. 5; *Submission 13*, p. 7.

7 Dr Brad Pragnell, Association of Superannuation Funds of Australia, *Committee Hansard*, 23 January 2007, p. 5.

8 *Committee Hansard*, 23 January 2007, p. 8.

> … we have, in the course of consulting with the super industry on this, been very cognisant of the implementation issues. They have taken the opportunity to raise those with us early. But there is a bit of a trade-off between reducing the complexity that would have been apparent from earlier proposals and having a system which is more limited in its application and does not introduce great complexity for the super funds to have to administer it. We have spoken to them about things like the way that they could build on systems they already have in place to make payments for other purposes. Depending on the final form of this legislation when it is enacted, we would more than happy to be talking to them further about those implementation issues. The examples [given by superannuation funds in the course of the committee's inquiry] about things like what the notices will look like, how they will recognise them and how they will know exactly how to comply with them are all issues that we can deal with … relatively quickly.[9]

3.15 The committee is satisfied that a delay in commencement of the Bill's substantive provisions is not warranted in the circumstances. However, the committee encourages ITSA to assist industry groups as much as possible with respect to implementation.

'Out of character' contributions and proof of intent

3.16 The committee engaged in some discussion at the hearing about the need for greater certainty in the Bill, particularly in relation to the meaning of the phrase 'out of character' in proposed subsections 128B(3) and 128C(4) and how proof of intention to defeat creditors would be ascertained in practice.

3.17 Witnesses told the committee that there does not yet appear to be any judicial guidance in relation to the phrase 'out of character'. However, witnesses agreed that the courts would play an important role in determining the meaning of this phrase. As Mr Cook from the IPAA told the committee:

> We would have to go to case law to find out, though, because of the term 'pattern of behaviour out of character'. We need a case that says, 'This is out of character,' and is more definitive. We will have to run cases. Those cases may have to be funded by the Commonwealth, and they may be prepared to do that.
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> …
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> My view is that trustees will be keen to take these cases on. It is pretty obvious what is out of character in one respect—you can see the elephant in the room. Then you have to go through the process of recovering. If you have a litigious bankrupt on the other side, you will take advantage of all the processes along the way. But I do not think it is that hard to spot an inappropriate pattern, I have to say.[10]

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9 *Committee Hansard*, 23 January 2007, pp 20-21.

10 *Committee Hansard*, 23 January 2007, pp 9 & 10.

3.18 Mr Michael Lhuede from the Law Council of Australia (Law Council) expressed a similar view, noting a preference for guidance from case law as opposed to the provision of greater certainty in the legislation itself:

> … I am loath to start bringing in examples. As a lawyer, I do not think it makes for good legislation. People tend to get tied down by that and courts tend to start interpreting from those examples.
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> …
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> The question you put to Mr Cook was: do we need to start defining the criteria? Courts can work it out, but the primary test of a trustee is not going to be those criteria. I think Mr Cook said that if you see the elephant in the room you can usually identify it. You can. The courts can and do. The primary question is one of proof of intent. You probably do not even need that section in there because there are a series of cases already on the books which say that the courts are to have regard to the surrounding circumstances in proof of intent. But you do not even need to go there if you can prove the person is insolvent. That is probably the primary means by which trustees will run a 121 case. Similarly, they will now run a 128B case.[11]

Ability of superannuation fund trustee to pay bankruptcy trustee an amount net of fees and charges

3.19 Some superannuation industry groups argued that, despite being strongly supportive of the policy objective set out in proposed subsections 128B(5A) and 128C(7A) (to ensure that, where a superannuation contribution is void, the trustee of the superannuation fund does not bear any loss resulting from fees, charges and taxes paid in respect of that contribution), the process involved is cumbersome and inefficient.[12]

3.20 Dr Pragnell from ASFA explained the process to the committee:

> First, the official receiver provides a notice of payment to the superannuation fund. Second, the superannuation fund pays the total amount of the contribution as specified in the notice to the trustee in bankruptcy. Finally, the trustee in bankruptcy is then required to pay back to the superannuation fund an amount equal to the fees, taxes and charges debited in respect of the contribution.[13]

3.21 This effectively means that the superannuation fund trustee is required to pay out a certain amount, only to then receive part of that amount back again.[14]

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11 *Committee Hansard*, 23 January 2007, p. 14.

12 For example, see ANZ Banking Group, *Submission 3*, pp 1-2; Superpartners, *Submission 5*, p. 2; Association of Superannuation Funds of Australia, *Submission 6*, pp2-3; AXA Australia, *Submission 8*, p. 3.

13 *Committee Hansard*, 23 January 2007, pp 2-3.

14 Association of Superannuation Funds of Australia, *Submission 6*, p. 3.

3.22 ASFA and the ANZ Banking Group suggested that it would be simpler and would avoid 'double handling' of payments if the superannuation fund trustee paid the net amount to the bankruptcy trustee:

> As it is only the superannuation fund trustee that is aware of the fees, taxes and charges debited in respect of those contributions, it would be far simpler if the law permitted the superannuation fund trustee to pay only the net amount and to advise the trustee in bankruptcy of the reason for the reduction in the payment.[15]

3.23 In their response to a question on notice, ITSA and the Department of the Treasury (Treasury) noted that in practice this is what currently occurs in relation to sections 120 and 121 of the Bankruptcy Act. ITSA and Treasury explained that the rationale for the process set out in the Bill is that the bankruptcy trustee will not know how to calculate these amounts and that it would be impractical to require the bankruptcy trustee to determine the net amount and limit recovery to that amount. However, the trustee/Official Receiver will accept the net amount as complying with the notice.[16]

Ongoing deduction of fees and charges for insurance

3.24 Some superannuation industry groups asserted that a definition of 'costs' should be inserted in section 128N of the Bankruptcy Act to permit the ongoing deduction of fees and charges associated with the provision of insurance cover so that a bankrupt continues to benefit from insurance cover in the event of death or disability.[17]

3.25 ITSA and Treasury provided the following response to this argument:

> The definition of 'costs' includes charges relating to the management or investment of fund assets or R[etirement] S[avings] A[ccount] assets. It is considered that this definition clearly includes normal administration fees associated with management of the account.
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> Insurance premiums may relate to a range of products. It would not be appropriate to provide a general carve-out for all such premiums as some may be considered discretionary spending which is not directly related to the provision of the superannuation product. The definition of 'costs' in section 128N includes a power to make regulations to extend the definition and the Government will consider more detailed representations from the superannuation industry when they are made.[18]

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15 Dr Brad Pragnell, Association of Superannuation Funds of Australia, *Committee Hansard*, 23 January 2007, p. 3.

16 *Submission 14*, p. 3.

17 For example, see Association of Superannuation Funds of Australia, *Submission 6*, p. 4; Investment and Financial Services Association, *Submission 13*, pp 3-4.

18 *Submission 14*, p. 2.

3.26 The committee is satisfied with the response from ITSA and Treasury and would encourage the Federal Government to consult further with the superannuation industry in relation to this issue.

Interaction between abolition of Reasonable Benefit Limits and the Bankruptcy Act

3.27 Some submissions and witnesses commented on the apparent inconsistency between section 116 of the Bankruptcy Act and the abolition of the pension Reasonable Benefit Limit (RBL) from 1 July 2007 under the Federal Government's Simplifying Superannuation reforms. Currently, under paragraph 116(2)(d) and subsection 116(5), superannuation and life insurance assets are protected in the event of bankruptcy up to a limit of the RBL, with only amounts above the superannuation RBL being available for redistribution.[19]

3.28 The Financial Planning Association of Australia (FPA) and Mr Lhuede from the Law Council submitted that the application of the removal of the pension RBL in the context of the Bill will need to be resolved.[20]

3.29 The committee notes advice from ITSA and Treasury indicating that the Federal Government is considering this issue but has not yet announced a response.[21] However, a representative from Treasury told the committee that there is an opportunity for legislative amendments in this regard in the bill currently before Parliament dealing with the simplification of superannuation.[22]

3.30 The committee also notes that the Institute of Chartered Accountants in Australia and Mr Lhuede from the Law Council expressed the view that some threshold limit for protection of superannuation from creditors would be appropriate.[23]

Committee view

3.31 The committee acknowledges the widespread support for the Bill in its attempt to overcome the potential loophole highlighted by the decision of *Cook v Benson*. The committee agrees that the Bill represents a balanced approach between the interests of bankrupts and the interests of creditors and, in this context, applauds the extent and nature of the Federal Government's consultation with relevant stakeholders.

3.32 The committee is satisfied by ITSA and Treasury's responses to some of the technical issues raised by submissions and witnesses. The committee considers that

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19 The current level of the pension RBL for the 2006-07 financial year is $1,356, 291: The Institute of Chartered Accountants, *Submission 1*, p. 1.

20 *Submission 12*, p 1; *Committee Hansard*, 23 January 2007, p. 12.

21 *Submission 14*, p. 1; *Committee Hansard*, 23 January 2007, p. 17.

22 *Committee Hansard*, 23 January 2007, p. 17.

23 *Submission 1*, p. 1; *Committee Hansard*, 23 January 2007, p. 12.

many of these issues are of a relatively minor nature and will be resolved once the Bill is implemented and its measures applied in practice. In particular, the committee notes evidence suggesting the importance of the role of the courts in developing the law and providing greater certainty in this area. The committee also commends the willingness of ITSA to assist and support industry throughout the implementation process. Accordingly, the committee recommends that the Senate pass the Bill.

Recommendation 1

3.33 The committee recommends that the Senate pass the Bill.

Senator Marise Payne
Chair